USTA does not say *how* hill-and-keep correctly allocates cost causation between the parties. or even whether this allocation is any better than the allocation under CPNP. Therefore. USTA's assertions provide no basis for a conclusion that bill-and-keep is justified because it provides an efficient allocation of costs or an allocation in accordance with cost causation. The comments of Verizon and SBC do not address the issue of relative efficiency at all.[131] BellSouth simply assumes that bill-and-keep will increase efficiency, but narrowly bases this supposition on purponed efficiency gains that will arise from the elimination of regulatory arbitrage.[132] BellSouth. however, provides no specific evidence of the magnitude of the efficiency gains,[133] and would he hard-pressed to do so since, as discussed elsewhere in these Reply Comments, bill-and-keep will not remove opportunities for regulatory arbitrage and may, in fact, heighten the opportunities.

V. THE FCC LACKS LEGAL AUTHORITY TO IMPLEMENT BILL-AND-KEEP

A. Local Traffic

The Joint Commenters noted in their initial Comments that Section 252(d)(2)(B)(i) precludes the use of arrangements that do not include "the mutual recovery of costs."[134] The Joint Commenters also observed that the bill-and-keep proposals being considered by the

131 *Id* at 4

132 *Id* at 5, *citing* BellSouth Comments at 16.

133 *Id* at 5

134 Focal/PacWest/RCN/US LEC Comments at 29. **citing 47** U.S.C. § 252(d)(2)(B)(i). ***See also,*** Section II., *supra*, discussing the ***Local Competition Order,*** in which the Commission ruled that hill-and-keep arrangements did not satisfy the standard of section 252(d)(2)(A)(i) because "hill-and-keep arrangements that lack any provisions for compensation do not provide for recovery **of** costs." ***Local Competition Order*** at ¶ 1112.

Commission would not provide for such mutual recovery when traffic is not balanced, nor would it provide a "reasonable approximation of the additional costs of terminating such calls" as required by Section 252(d)(2)(A)(ii).[135] The Joint Commenters stated that while the Act allows for use of bill-and-keep arrangements those arrangements may only be mandated when traffic is in balance between the two parties. When traffic is not in balance, then bill-and-keep should be limited to voluntary arrangements where parties agree to waive their mutual recovery of costs for some *quid pro quo*.[136] Finally, the Joint Commenters noted that by mandating bill-and-keep for Section 251(b)(5) traffic, the Commission might be encroaching on the authority of state commissions under Section 252(c)(2) to set rates.[137]

Numerous commenters echoed the limitations on the Commission's authority to impose bill-and-keep for local traffic. Global NAPs observes that given the statutory language in Section 252(d)(2). it is hard to see how the Commission could establish a mandatory bill-and-keep regime for Section 251(b)(5) traffic.[138] Time Warner states that the requirements of "mutual recovery of costs" and "offsetting of reciprocal compensation obligations" in the Act create difficult legal problems for the Commission in regard to implementing a bill-and-keep regime. Time Warner contends that the situation for the Commission is made more difficult because the Commission lacks authority to forbear from Sections 251(b)(5) and 252(d)(2).[139] KMC argues

135 Focal/PacWest/RCN/US LEC Comments at 30-31, *citing* 47 U.S.C. § 252(d)(2)(A)(ii).

136 Focal/PacWest/RCN/US LEC Comments at 32. *citing* 47 U.S.C. § 252(d)(2)(B)(i).

137 Focal/PacWest/RCN/US LEC Comments at 33, *citing* 47 U.S.C. § 252(c)(2).

138 Global NAPs Comments at 16.

139 Timr Warner Trlecom Comments at 27-28.

that bill-and-keep regimes do not meet the "compensation" requirement of Section 251(b)(5) or "the reasonable approximation of the additional costs" requirement of Section 252(d)(2) because a bill-and-keep regime would lead to a reciprocal compensation rate of zero for surplus traffic where traffic flows between carriers are not roughly equal. KMC also contends that bill-and-keep would violate Section 201(b) of the Act, which requires that "all charges, practices, classifications, and regulations" be "just and reasonable," and a rate of zero is not just and reasonable.[140]

AT&T argues that the Act prohibits an across-the-board bill-and-keep rule for the transport and termination of telecommunications. AT&T observes that the mutual recovery of costs is not afforded, and cannot be afforded, when traffic is out of balance, and recovery cannot be afforded reciprocally when carriers are required to recover costs from end users.[141] CompTel submits that mandating bill-and-keep would violate the Act, the U.S. Constitution, and the WTO Basic Telecom Agreement Reference Paper on Pro-Competitive Regulatory Principles.[142]

It is not only the competitive providers of local exchange service that voice serious reservations about the Commission's authority to implement bill-and-keep for local traffic. NASUCA argues that mandating bill-and-keep will violate the Act's requirement that LECs negotiate reciprocal termination charges and adopting bill-and-keep as a default would remove

140 KMC Telecom Comments at 5.

141 AT&T Comments at 38-39.

142 CompTel Comments at 3, 22-25

all incentives to negotiate in good faith.[143] The Ronan Telephone Company and Hot Springs Telephone Company ("RTCIHSTC"), two rural ILECs, state that mandating bill-and-keep where traffic is not in balance would be a "blatant violation" of the Act and probably an unconstitutional taking.[144] RTC/HSTC posits that the Commission could only mandate bill-and-keep where traffic is equal or very close to being equal and where the respective costs of termination are proven to be the same.[145]

The parties that support the Commission's authority to mandate bill-and-keep at best make a case that bill-and-keep is one of a range of possible intercarrier compensation arrangements that the Act allows, but proffer no basis as to how the Commission can mandate that it he the exclusive option.[146] Clearly from the language of the Act, intercarrier payments were presumed to be the predominant form of reciprocal compensation. **As** BellSouth notes. the definition of "reciprocal" is "given or owed mutually as between two parties; interchanged."[147] The term mutual means "reciprocally acting, giving, receiving, interchanging."[148] Thus, by its plain meaning, reciprocal compensation contemplates compensation that is owed between two parties and that is interchanged between parties. Nowhere is the language is there a suggestion that carriers should rely on their end users to recover their costs of terminating calls.

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143 NASUCA Comments at **29**

144 Ronan Telephone Company and **Hot** Springs Telephone Company Comments at 3-4

145 *Id*

146 *See*, BellSouth Comments at 18

147 BellSouth Comments at ***22.***

148 *Id*

The Act does provide for "bill-and-keep" arrangements but as a limited exception to the rule. The Commission rightfully gave proper definition to the limited nature of the exception by allowing such arrangements only when traffic is balanced between the parties.[149] Proponents of the bill-and-keep approach seek to make it the rule, not the exception, however, and the Act does not support such an extension. Even Qwest, a proponent of bill-and-keep, notes in regard to the provision in Section 252(d)(2)(A) that allows for bill-and-keep:

> While this language is unclear in some respects, it could not be plainer in preserving at a minimum, 'arrangements that waive mutual recovery (such as bill-and-keep arrangements).'""

The language. however, simply provides the limited nature of the exception and does not provide any authority to mandate bill-and-keep where parties do not agree to waive their right to mutual recovery.

The limited nature of the exception fits in with what NASUCA notes are "decades of experience in interconnection in telecommunications."[151] NASUCA describes the experience as follows:

> Bill-and-keep contracts were negotiated some of the time, but only where the traffic was balanced. In situations where traffic is out of balance, a settlement payment was made by the company that originated the majority of the calls. The pricing structure was also reflected in end user rates. The originating party paid for the cost of interconnection. Furthermore, the retail rates were generally designed so that the customers who initiated the calls paid for the calls, rather than

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149 *Local Competition Order* at ¶ 1112

150 Qwrst Comments at n 25

151 NASUCA Comments at 7

having the cost of interconnection distributed evenly among the customers.'"

There are significant statutory obstacles to mandating a bill-and-keep regime. For instance, proponents of bill-and-keep attempt to get beyond the requirement of "mutual recovery" of costs by arguing that recovery from end users provides such recovery.[153] **As** Joint Commenters have noted. however, when their traffic is not balanced, carriers do not recover their costs and will have to transfer these costs to their end users through higher local rates. **As** noted above, the definitions of ''mutual'' and "reciprocal" contemplate that recovery would come from the other carriers that were using the camer's facilities and not from their customers.

Likewise. Qwest attempts to get beyond the requirement that an originating carrier must pay "a reasonable approximation of the additional costs of terminating such calls" by suggesting that "additional costs" could be reasonably construed to include only the "short-run (per-call) incremental costs of delivering traffic to the called party."'" Qwest argues that ***"those*** costs may well be negligible, because . . . individual calls do not typically 'cause' transport and termination costs; those costs instead consist of lumpy investments needed to ensure peak load capacity."[155] The statute speaks of the "additional costs of terminating such calls"; thus, it is not focused on the incremental costs of one call but on the incremental costs of delivering all such calls to the terminating carrier's customer. The "lumpy investments" needed to provide the capacity to

152 *Id*

153 SBC Communications Comments at 43; Sprint Comments **at 20.**

154 Qwest Comments at 42

155 *Id*

terminate such calls would surely fall under the incremental costs of terminating such calls. These costs are surely not negligible, particularly, when traffic is not balanced. When traffic is not balanced, one carrier would face numerous "additional costs" in providing the facilities to terminate the other carriers' traffic. but would not be compensated for such calls. The California Public Utilities Commission, which in 1995 had actually set bill-and-keep as an interim default mechanism for intercarrier compensation for local traffic where the parties did not agree on compensation, recognizes that when traffic is not balanced, there is a need to establish an intercarrier compensation mechanism to send proper pricing signals.[156]

Qwest. clearly recognizing that unbalanced traffic is an obstacle to bill-and-keep, suggests that a bill-and-keep regime would "remove most of the arbitrage opportunities that create large categories of unbalanced intercarrier traffic."[157] As the Joint Commenters noted, however. unbalanced traffic is to be expected in the early stages of a competitive market as competitive carriers focus on specialization and niche marketing that are vital to promoting competition.[158] This sentiment was echoed by the Ad Hoc Telecom Users, which note that both papers assume that any intercarrier compensation structure that results in a less than balanced traffic flow is flawed and must be changed. The Ad Hoc Telecom Users argue that this assumption is "unsupported by factual or economic evidence, is untested and is most likely untrue."[159] There is no reason to believe that LECs with overlapping service territories would have balanced traffic

156 California Public Utilities Commission Comments at 4-5

157 Qwest Comments at 43

158 Focal/Pac-West/RCN/US LEC Comments at 12-14

159 The Ad Hoc Telecom Users Comments at 6-7

As the Ad Hoc Telecom Users astutely observe.

> [P]rior to the introduction of competition in the local service market. when LECs provided service within non-geographically overlapping service areas, the expectation (and the reality) was that the transfer of traffic between carriers would be relatively 'in balance.' The introduction of competitors into this segment changes the paradigm, and there is no longer any reason for the expectation that traffic will be in balance. The natural laws of competition dictate that if and to the extent that local service competitors can find particular classes of customers for whom they are able to originate or terminate calls (either because of greater efficiency than the ILECs, the use of less expensive technology than the ILECs, or above cost pricing by the ILEC) at a cost that is lower than what it would have cost to have the ILEC originate or terminate those calls, then they should be successful in marketing those services to those particular classes of customers. At the present time, CLECs have found that situation to exist for customers that receive large volumes of incoming calls (terminating traffic), and have taken advantage of the real and natural opportunities for that segment.[160]

Qwest, however, is seeking to make competitive carriers mimic Qwest's traffic patterns. This balance in traffic is one that would be forcefully imposed through regulation and require that certain market segments with high-volumes of terminating traffic he underserved

It is very telling that another proponent of bill-and-keep, Sprint, suggests that if the Commission is concerned that "Section 252(d)(2)(B) does not confer upon it legal authority to adopt a bill-and-keep regime, it could rely upon its authority under Section 10 of the Act to forbear from applying requirements relating to reciprocal compensation."[161] This is an implicit recognition of the statutory obstacles to the imposition of a hill-and-keep regime for Section 251(b)(5) traffic. **As** Time Warner, notes, however, the Commission does not have authority to forbear from the reciprocal compensation provisions. The Commission does not have the

160 *Id*

161 Sprint Comments **at 21**

authority to forbear from the requirements of Section 251(c),[162] and Section 251(c) incorporates the obligations of Section 251(b) that include reciprocal compensation.[163] In addition, Section 10(b) requires the Commission in making its forbearance determination to consider "whether forbearance from enforcing the provision or regulation will promote competitive market conditions, including the extent to which such forbearance will enhance competition among providers of telecommunications services."[164] Numerous commenters have noted how bill-and-keep would not promote competition but stifle it, and enhance the competitive position of the incumbents. Given the nascent state of the local competition market, and the precarious state of competition in the local market, there would be no basis for forbearance.

The approach most supported by the statute is to maintain the current compensation system for Section 251(b)(5) traffic and to allow carriers to negotiate bill-and-keep arrangements voluntarily where the situation so warrants. The Commission would only have the authority to mandate bill-and-keep for such traffic if the traffic is roughly in balance.[165]

B. ISP-bound Traffic

The Joint Commenters argued in their initial Comments that the Commission's determination that ISP-bound traffic is "information access" under Section 251(g) is erroneous

162 47 U.S.C. § 160(d)

163 Time Warner Comments at 28-29. *citing*. Letter from Carol E. Mattey, Deputy Chief of the Common Carrier Bureau. to Michael L. Shor, ***Bell Atlantic/GTE Merger Order,*** 16 FCC Rcd. **22, 23** (2000) (concluding that "Section 251(b) is incorporated explicitly into section 251(c) at the outset of the subsection.")

164 47 U.S.C. § 160(b).

165 Focal/PacWest/RCN/US LEC Comments at 31; KMC Comments at 3

and does not provide a basis to support a bill-and-keep regime for ISP-bound traffic.[166] The Joint Comnienters noted that Section 251(g) does not provide the broad statutory authority that the Commission has recently imbued it with, and represents a complete reversal of the Commission's reading of the section.[167]

AT&T also concurs that the Commission's conclusion that Section 251(g) "carves out ISP-bound traffic from the requirements of Section 251(b)(5) is fundamentally misguided."[168] AT&T agrees that Section 251(g) is a "narrow transitional provision that ensures that the 1996 Act amendments did not inadvertently relieve dominant incumbent LECs of their pre-existing equal access and non-discrimination obligations to interchange carriers and information service providers."[169] This is corroborated by the legislative history of Section 251(g).[170] By its terms, Section 251(g) was only intended to preserve "obligations 'that apply . . . on the date immediately preceding [the date of enactment] February 8, 1996 [of the Act].'"[171] The Commission, however. did not have a pre-existing rule governing inter-carrier compensation for ISP-bound, traffic and did not implement one until this year.[172]

166 Focal/Pac-West/RCN/US LEC Comments at 33-34

167 *Id.* at 35-36.

168 AT&T Comments at 43

169 *Id*

170 *Id.*, citing. H.R. Rep. 104458, at **123.** ***reprinted in*** 1996U.S.C.C.A.N. **124,** 134 (1996)("Because the [1996 Act] completely eliminates the prospective effect of the [Consent Decree], some provision is necessary to keep these requirements in place . . . Accordingly. the conference agreement includes a new section 251(g).")

171 *Id.* at 45

172 *Id.*, *citing*, ***Implementation of the Local Competition Provisions in the Telecommunications Act of 1996,*** Declaratory Ruling, 14 F.C.C. Rcd. 3689.77 9, 22 (1999) ("Currently the Commission has no rule governing iter-

(con't.)

If the Commission fails to prevail on its reading of Section 251(g) before the D.C. Circuit, then the Commission should resign itself to the reality that such traffic is governed by Section 251(b)(5). At the very least, the Commission should not embark on any compensation reform that would entail differential treatment for ISP-bound traffic until the Commission's authority to do so is validated by the D.C. Circuit.

C. Interstate Access Charges

While the Commission may have broad authority in regard to interstate access charges, there are significant obstacles to implementing bill-and-keep for interstate access charges. Rural and independent ILECs predict a tremendous increase in rural and independent LEC retail rates under bill-and-keep. Not only would cost recovery be shifted away from IXCs and onto end users. but many parties also noted that bill-and-keep for interstate access charges would shift substantial costs from the interstate jurisdiction to the intrastate jurisdiction in contravention of long-established separations policies articulated by the U.S. Supreme Court in ***Smith v. Illinois.***[17] NECA laments that the Commission gives little consideration to separations issues, and that while the Commission's proposal is characterized as forward-looking, it is actually a return to methods long since discredited in the separations process. NECA notes that CPNP methods are not a product of happenstance. Today's intercamer mechanisms, including current separations methodologies and access charge regimes, are the product of more than a century of cooperative effort by federal and state regulators. Bill-and-keep could undermine existing

carrier compensation for ISP-bound traffic ")

[17] YTCA Comments at 14-15; NECA Comments at **12**

jurisdictional separations.'"

D. Intrastate Access Charges

Even the strongest proponents of bill-and-keep admit that the issue of jurisdiction over intrastate access charges presents a formidable obstacle to the imposition of a mandatory bill-and-keep regime.[175] There is nothing in the Act that gives the Commission rulemaking authority to prescribe bill-and-keep for intrastate access. While the Supreme Court in *Iowa Utilities Board* gave the Commission broad authority to implement the local competition provisions of the Act, the Court did find that section 2(b) of the Act and *Louisiana* ***Pub.*** *Serv. Comm'n v. FCC*, 476 U.S. *355* (1986) places a limit on Commission authority where it attempts to regulate services over which it has "not explicitly been given rulemaking authority."[176] Thus, the Commission would have no authority to mandate that states impose a bill-and-keep mechanism for intrastate access charges."' As Time Warner astutely observes:

> This threshold issue [legal authority to implement bill-and-keep for intrastate access traffic] should be resolved before the Commission expends significant resources on considering the manner in which bill-and-keep should be implemented at the federal level. The extent to which bill-and-keep can be adopted at the state level is an important factor that must be weighed as part of the

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174 NECA Comments at **12.**

175 Qwest Comments at 45

176 *AT&T Corporation v. Iowa Utilities Board,* **525** U.S. 3t 381 ɛ ı. 7 (1999); ***see*** *also.* Pɛ .W. Huber, *et al., Federal Telecommunications Law* at § 3.3.4 (Zd ed. 1999); **see** *also,* CC Docket No. 99-68, Reply Comments of the Association for Local Telecommunications Services at 16, **n.** 26 (Apr. *21,* 1999) (In those instances where the "1996 Act's local competition provisions are 'silent."' Justice Scalia "acknowledges that '[Section 2(b) continues to function] '"

177 **4 s** noted elsewhere in these Comments. if bill-and-keep is applied on a federal basis, there will continue to he opportunities for regulatory arbitrage.

cost-benefit analysis in this proceeding."'

Further, as discussed above. there are significant perils in a piecemeal approach to implementation of a bill-and-keep regime. It is clear that the Commission does not have authority to impose bill-and-keep for intrastate access charges. The only "unified intercarrier compensation regime" available to the Commission is the existing CPNP regime. Once subsidies are eliminated from access charges and replaced with explicit universal service support mechanisms. and originating and terminating rates are set at cost, the Commission's hope for a unified regime will have some foundation.[179]

VI. IMPOSING BILL-AND-KEEP WILL REQUIRE MAJOR NEW FEDERAL PROGRAMS

In their initial comments in this proceeding, the Joint Commenters pointed out that bill-and-keep would require major new regulatory programs and proceedings.[180] First, the bill-and-keep proposals being considered would alter end user rates significantly and require new federal end user charges. States would be unwilling to raise local rates, so federal rates would have to be crafted.[181] Second, the Commission would have to transform the existing complex system of access charges into a program of federal end user charges. In addition, the Commission would

178 Time Warner Comments at 29

179 In the *Local Competition **Order.*** the Commission recognized that "transport and termination of traffic, whether it originates locally or from a distant exchange. involves the same **network** functions. Ultimately. we believe that the rates that local carriers impose for the transport and termination of local traffic and the transport and termination of long distance traffic should converge." *Local **Competition Order*** at ¶ 1033. Thus. cost based transport and termination rates complete the unified intercarrier compensation regime.

180 Focal/PacWest/RCN/US LEC Comments at 6-12.

181 Focal/PacWest/RCN/US LEC Comments at **7**

need to establish new and separate end user charges covering the LEC's cost of providing local exchange terminating service to ISPs, now that the Commission has exercised exclusive jurisdiction over this traffic.'" Third, bill-and-keep would require entirely new intrastate retail pricing structures.[183] Finally, the bill-and-keep proposals under consideration would require close regulatory oversight over interconnection between local exchange carriers.[184] The comments by other parties demonstrate that the Joint Commenters' concerns are well founded. The "quick fix" envisioned by the Commission's bill-and-keep proposals would be anything but quick. and it is questionable whether there is anything to fix

The ILECs and other commenters amply describe the sorts of comprehensive reform that must be undertaken if a bill-and-keep regime is to be implemented:[185] radical changes to the cost and revenue structures of small and rural ILECs would have to be imposed;[186] access charges must be restructured for rate-of-return companies;'" universal service support mechanisms must be made explicit;[188] inefficient retail rate structures must be corrected and residential rates must he raised to reflect true cost;[189] the Federal-State Joint Boards on Universal Service and

182 Focal/PacWest/RCN/US LEC Comments at 7-8.

183 Focal/PacWest/RCN/US LEC Comments at 10

184 Focal/PacWest/RCN/US LEC Comments at 11-12

185 SBC Comments at 19-32; Qwest Comments at 31-40; Verizon Comments at 19; Sprint at 2; ALLTEL Comments at ii; CenturyTel Comments at 2.

186 NRTA/OPASTCO Comments at 15-19: NECA Comments at ii-iii

187 NTCA Comments at 1

188 NECA Comments at 11; NTCA Comments at *6:* MSTG Comments at 14; Qwest Comments at 30-31; United States Telephone Association (USTA) Comments at **26;** SBC Comments at **11**; ALLTEL Comments at 12.

189 SBC Comments at 9, 21; The Ad Hoc Telecom **Users** Comments at 4

Separations must be convened to consider any transition to bill-and-keep;"" and contrary to the claims that bill-and-keep would be deregulatory, regulatory oversight must be continued, including setting rates and evaluating cost studies."' Accordingly, initial comments amply verify Joint Commenters concerns that bill-and-keep would necessitate a host of new intrusive federal regulatory programs.

VII. THE COMMISSION SHOULD REITERATE THAT ILECS MUST ABIDE BY ITS "RULES OF THE ROAD"

A. The BOCs Acknowledge the Soundness of the Single POI per LATA Requirement

In the *NPRM,* the Commission asked whether an ILEC should be required to bear its own transport costs when a CLEC establishes a point of interconnection ("POI") outside the local calling area of the ILEC end user originating a call to a CLEC customer.[192] The Joint Commenters stated that the Commission should retain the rule that allows a CLEC to establish a single POI per LATA because any other rule would introduce inefficiencies and would require CLECs to mimic anachronistic ILEC local calling areas.[193]

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190 NARUC Comments at 1, 4; Florida Public Utility Commission Comments at 1; Regulatory Commission of Alaska Comments at 4-5; Iowa Utilities Board Comments at 3; Missouri Public Service Commission Comments at 4; NASUCA Comments at 26; Texas Public Utility Commission Comments at 2; NRTA/OPASTCO Comments at 8; NTCA Comments at *6;* NECA Comments at 4; Sprint Comments at 27.

191 AT&T Comments at 5-6, 26-29, 35; Z-Tel Comments at 5-6; Maryland Office of People's Counsel Comments at 34-36: WorldCom Comments at 25-26: Illinois Commerce Commission Comments at 10; Time Warner Comments at 12-13; Qwest Comments at 25; Allegiance Comments at 28.

192 *NPRM* ¶ 113

193 Focal/PacWest/RCN/US LEC Comments at 16-18, 55-56

The BOCs that addressed the issue agree that a single POI per LATA is the appropriate default rule. For example, Qwest recognizes that any resolution of this issue should seek to reduce regulatory intervention.[194] A single PO1 per LATA requirement would certainly reduce regulatory intervention– each carrier is responsible for all transport on its side of the POI. If it is more efficient for a carrier to lease transport facilities on its side of the POI than it would be to provide them itself, it will make that decision completely independent of whatever arrangements the other camer makes on its side of the POI. Further, with a single POI per LATA as the default rule. carriers are free to negotiate around that rule to provide for more efficient traffic exchange arrangements where circumstances warrant. Qwest's concern about providing an originating carrier with some flexibility to determine where it will deliver traffic to the terminating carrier could be adequately addressed through negotiations. [195]

While SBC contends that it should be compensated for providing transport beyond the local exchange area of the calling party under the current single POI per LATA rule,[196] it proposes a single POI per LATA for the exchange of traffic between local calling areas under a bill-and-keep regime.[197] This rule, according to SBC, "encourages carriers to build out their networks and prevents them from unfairly transferring transport costs to the calling party's service provider."[198] The Joint Commenters completely agree with this statement. The Joint

194 **Qwest** Comments **at** 29

195 *Id* at 29-30

196 SBC Comments **at** 18-19

197 *Id* **at 27**

198 *Id* **at** 30

Commenters, however, find it amusing that SBC suddenly agrees with CLECs and realizes that establishing a single POI per LATA makes great economic sense – when the alternative to SBC is transport to the CLEC end office for calls that SBC customers originate, as would be the case under the COBAK proposal. Yet SBC seems to forget that economic rationality under a CPNP regime when it suggests it should always be compensated for all transport out of its own local calling areas. It is a convenient flip-flop, but inconsistent. The proper conclusion is that, in all circumstances, a single POI per LATA is the efficient default rule for interconnection. As SBC itself acknowledges, the "death of distance" in telecommunications pricing is imminent.[199] It makes no sense to predicate interconnection requirements on a near-obsolete regulatory distinction that has no sound technological basis. The only distinction should be the one imposed by the Act, which prohibits BOCs from providing interLATA service.

BellSouth also proposes a single POI per LATA under a bill-and-keep regime.[200] Verizon discusses the transport issues raised in the *NPRM* obliquely, and merely proposes that "[t]he Commission should send the right signals to the market and encourage efficient interconnection by not placing unreasonable burdens on one interconnecting carrier as opposed to the other, by not allowing regulatory arbitrage and by not encouraging carriers to offer uneconomic services."[201] In response, the Joint Commenters simply restate SBC's position – a single POI per LATA "encourages camers to build out their networks and prevents them from unfairly

199 *Id* ai **19**

200 BellSouth Comments at 14-15

201 Verizon Comments at 11

transfemng transport costs to the calling party's service provider."[202]

B. The Commission Should Not Abandon its Tandem Treatment Rule

The Cornmission correctly confirmed that Section 51.711(a)(3) requires a carrier to demonstrate only that its switch serves "a geographic area comparable to that served by the incumbent LEC's tandem switch" in order to be entitled to the tandem switch reciprocal compensation rate.[203] The Commission also asked, however, whether a "functional equivalency" concept should be added to the test of whether a CLEC is entitled to receive the tandem switch reciprocal compensation rate.[204]

There is no principled reason to revise this rule to also require a "functionality" test. The Commission recognizes that language in the *Local Competition **Order*** may have created some confusion in the implementation of this rule, but the functionality test used by some states completely ignores the intent of the rule and inappropriately relies on network distinctions found only in the ILEC network.

Section 5 1.711(a)(3) was intended to recognize that some carriers use fiber rings or wireless transmission facilities instead of hub-and-spoke tandem-switched network architecture."'-'Even though carriers may use alternate network architectures, they may still have the ability to transport and terminate traffic over a geographic area as large as the area served by

202 SBC Comments **at 30.**

203 *NPRM* at ¶ 105.

204 *NPRM* at ¶ 107.

205 *Local Competition **Order*** at ¶ **1090**

the ILEC tandem switch. Accordingly. they should be compensated comparably regardless of the network architecture they choose.

Further, the "functionality" that some states have required CLECs to provide inappropriately relies on network distinctions found only in the ILEC network. Tandem switch "functionality" in the ILEC network is the ability to provide switching between switches, or to connect trunks to trunks. Yet there is no particular value added by providing switching between switches. except to be able to route calls to destinations within a geographic area that are not served by the end office switch of the calling party. A CLEC network using a fiber ring and a single switch completes this identical "function." A functionality test has only one purpose—to deny comparable compensation to the CLEC when it provides the same service that the ILEC tandem switch provides. Accordingly, the Commission should retain the rule, without revision, that permits a CLEC to be paid the tandem rate when its switch serves a geographic area comparable to the area served by the ILEC tandem switch.

C. Calls to ISPs Are Subject to the *ISP Traffic Remand Order* Regardless of Whether the LEC Assigns the ISP a Physical or Virtual NXX

The Commission also asked for comment regarding the use of "virtual" central office codes.[206] The Joint Commenters stated that CLEC use of virtual central office codes was a competitive response to substantially similar services provided by the BOCs to ISPs.[207] The Joint Commenters also stressed that the physical location of the terminating carrier's customer has no

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206 *NPRM* at ¶ 115

207 Focal/PacWest/RCN/US LEC Comments **at** 57-59

to the CLEC POI, yet the same Venzon–New England, Inc. affiliate in Maine complaining of this practice has executed a negotiated interconnection agreement in New Hampshire that specifically allows the practice and provides compensation for it."' Similarly, SBC calls this practice "yet another arbitrage problem."'" yet it also has signed negotiated interconnection agreements permitting the practice.".'

Further. several states have approved and validated the use of virtual NXX codes. The states of Michigan. California, North Carolina, and Kentucky agree that calls are rated by comparing the NXX codes of the calling and the called parties, regardless of the physical location of the called party."' As the North Carolina Utilities Commission explained in an arbitration proceeding between BellSouth Telecommunications, Inc. and MCImetro Access Transmission Services, LLC,

The Commission notes that NPA/NXX codes were developed to rate calls and,

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212 Focal-Verizon New England Agreement: Amendment No. 1 to Interconnection Agreement between Verizon-New England, Inc. and Global NAPs, Inc., Section 3, adding new Section 1.94 to the Agreement ("'Compensable Internet Traffic' means dial-up switched Internet Traffic that is originated by an end-user subscriber ***of*** one Party, is transmitted to the central office switch of the other Party that is physically located in the state of New Hampshire. and then is handed off by that Party to an Internet Service Provider located in the state of New Hampshire that has been assigned a telephone number or telephone numbers within an NXX or NXXs which are local to the originating end-user subscriber.").

213 SBC Comments at 17

214 ***Set..*** *e.g.*, Amendment No. ***2*** to Interconnection Agreement between Ameritech Ohio and ICG Telecom Group. Inc.. Section **4.2** ("If ICG designates different rating and routing points such that traffic that originates in one rate center is carried by Ameritech to a routing point designated by ICG in a rate center that is not local to the calling parry even though the called NXX is local to the calling patty. such traffic ('Virtual Foreign Exchange' traffic) shall be rated in reference to the rate centers associated with the NXX prefixes ofthe calling and called parties' numbers, and treated as Local traffic for purposes of compensation.")

215 ***In re Complaint of Glenda Bierman against CenturyTel of Michigan, Inc. d/b/a CenturyTel***, Opinion and Order. Case No. U-11821 (Mich. PSC Apr. 12, 1999): ***In the mutter of the application of Ameritech Michigan to revise its reciprocal compensation rates and rate structure and to exempt foreign exchange service from payment of reciprocal compensation.*** Case No. U-12696 (Mich. PSC Jan. 23, 2001).

ıevance to the amount of transport that the originating party must provide to complete a call.[208] Finally, the Joint Commenters explained that a "virtual" presence in any local calling area begins with the questionable premise that CLECs must adhere to ILEC local calling area boundaries.[209] The BOCs respond to the questions posed in the *NPRM* by little more than impugning CLECs that provide customers with telephone numbers that allow them to have calls to them rated as local calls under the ILEC system of rating traffic. Verizon goes so far as to call this practice a "fraudulent misuse of telephone numbers" or a "theft of service scheme."[210] It is odd, then, that Verizon would sign a series of freely negotiated contracts, which any CLEC could have opted into and ported into another state under the Bell Atlantic-GTE merger conditions, that permit CLECs to use these so-called virtual NXX arrangements and receive terminating compensation from Verizon."' It is also rather curious that Verizon cites what it calls "the Maine Game" in its comments to refer to a situation in which Verizon transports traffic more than one hundred miles

208 Focal/PacWest/RCN/US LEC Comments at 58

209 Focal/PacWest/RCN/US LEC Comments at 58

210 Verizon Comments at 4-5.

211 *See, e.g.*, Interconnection Agreement between Venzon-Virginia, Inc., and Focal Communications Corporation of Virginia, Section 1.16 ("'Compensable Internet Traffic' means dial-up switched Internet Traffic that ıs originated by an end-user subscriber of one Party, is transmitted to the switched network of the other Party, and then is handed off by that Party to an Internet Service Provider which has been assigned a telephone number or telephone numbers within an NXX or NXXs which are local to the originating end-user subscriber."); Interconnection Agreement between Verizon-Maryland, Inc.. and Focal Communications Corporation of the Mid-Atlantic. Section 1.16 (same); Interconnection Agreement between Verizon-Washington, D.C.. Inc., and Focal Communications Corporation of the Mid-Atlantic, Section 1.16 (same);Interconnection Agreement between Verizon-New England. Inc., and Focal Communications Corporation of Massachusetts, Section 1.16 (same) ("Focal-Verizon New England Agreement"); Interconnection Agreement between Verizon-New York, lnc., and Focal Communications Corporation of New York. Section 1.16 (same); Interconnection Agreement between Verizon-Pennsylvania, Inc.. and Focal Communications Corporation of Pennsylvania, Section 1.16 (same); Interconnection Agreement between Verizon-Delaware. Inc., and Focal Communications Corporation of Pennsylvania, Section 1.16 (same): Interconnection Agreement between Verizon-New Jersey, Inc., and Focal Communications Corporation of New Jersey. Section 1.16 (same).

> therefore, MCIm's assertion that whether a call is local or not depends on the NPA/NXX dialed. not the physical location of the customer, is reasonable and appropriate. Further, based on the FCC's 1980 ruling in the New York Telephone case and MCIm witness Price's testimony at the hearing. the Commission believes that these calls should be classified as local as long as they are originated and terminated within a LATA. Therefore, the Commission concludes that calls within a LATA originated by BellSouth customers to MCIm FX customers are to be considered local and, therefore. subject to reciprocal compensation.[216]

The California Public Utilities Commission has ruled repeatedly and unambiguously that a local call is determined by the NF'A-NXX of the called and calling party, regardless of the location of the ISP. The California Commission determined that "[w]hether an ISP-bound call should be treated as local is based on the rating of the call measured by the distance from the rate center associated with the originating caller's telephone number to the rate center associated with the telephone number used to access the ISP modem."[217]

The issue of intercamer compensation for virtual NXX traffic was also addressed in the arbitration proceeding between Level **3** and BellSouth before the Kentucky Public Service Commission. The Kentucky Commission ruled in favor of Level **3,** saying "foreign exchange and virtual NXX services should be considered local traffic when the customer is physically located within the same LATA as the calling area with which the telephone number is associated."[218]

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216 ***Petition of MCImetro Access Transmission Services, LLC for Arbitration of Certain Terms and Conditions of Proposed Agreement wirh BellSouth Telecommunicatrons. Inc. Concerning Interconnection and Resale Under the Telecommunications Act of 1996,*** Recommended Arbitration Order, Docket No. P-474, Sub 10 (NCUC April 3, 2001) **at** 74, upheld and affirmed, Order Ruling on Objections and Requiring the **Filing** of the Composite Agreement (NCUC, Aug. 2. 2001), at 28.

217 Order Instituting Rulemaking on the Commission's Own Motion Into Competition **for** Local Exchange Service, Rulemaking 95-04-043, Investigation 95-04-044 (Cal P.U.C. September 3, 1999); ***Level 3 Communications. LLC Petition for Arbitration Pursuant to Section 252(b) of the Communications Act of 1934. as amended bv the Telecommunications Act of 1996, for Rates. Terms. and Conditions with Pacific Bell Telephone Company***, D. 00-10-032. Application 00-04-037 **(Ca.** PUC Oct. 5,2000).

218 ***In re Petition of Level 3 Communications. LLC for Arbitration with BellSouth Telecommunications, Inc.***

(con't.)

In fact. the use of virtual NXX arrangements has brought the Internet to previously underserved locations. As the Public Utility Counsel of Texas recognizes, virtual NXX arrangements are "critical" to ISPs.[219] The Public Utility Counsel of Texas recognizes that the use of virtual NXX arrangements do not deprive originating carrier of access charges and universal service subsidies contained therein because ISP subscribers would rarely, if ever, place toll calls to reach an ISP.[220] ILEC toll revenues are not at risk because those toll revenues would not exist even if CLECs did not use virtual NXX arrangements

In addition, calls to ISPs using virtual NXX arrangements are already subject to the restrictions and requirements imposed on CLECs serving ISPs by the Commission's *ISP Traffic Remand Order.*'" The rules applicable to the transport and termination of traffic to ISPs make no distinction between calls using virtual NXX arrangements and those using non-virtual NXX arrangements.[222] All ISP-bound traffic is compensated at the applicable rates under the federal regime in the *ISP Traffic Remand Order,* and the *NPRM* provides no reason to vary from that result for virtual central office code traffic

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Pursuant to Section 252(b) ofthe Communications Act of 1934, as Amended by the Telecommunications **Act** *of 1996*, Order, Case No. 2000-404 (Ky. P.S.C. Mar. *14,* 2001).

219 Public Utility Counsel of Texas Comments at 118.

220 *Id*

221 *ISP Traffic Remand Order* at ¶¶ 77-94. *Implementation of the Local Competition Provisions in the Telecommunications Acr of 1996; lnrercarrier Compensationfor ISP-Bound Traffic*, CC Dkt *Nos*. 96-98, 99-68, Order on *Remand* and Report and Order, FCC 01-131 **(rel. Apr.** 27, *2001)* at ¶ *44* (*"ISP Traffic Remond Order").* Focal, Pac-West. RCN, and US LEC have intervened in the appeal of the *ISP Traffic Remand Order* **at** the United States Court of Appeals for the District of Columbia Circuit. *WorldCom, Inc. v. FCC*, Dkt. *01-1218* (D.C Cir.) *The* positions taken here by Focal. Pac-West, RCN, and US LEC are not to be construed as an acknowledgment by them of the lawfulness of the *ISP Traffic Remand Order*

222 Focal/PacWest/RCN/US LEC Comments at *60*

VIII. CONCLUSION

For these reasons, the commission should abandon its proposal to implement bill-and-keep

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Dated: November 5, 2001

FCC COMMON CARRIER DOCKET NO. 01-92:

RESPONSE TO ECONOMIC ANALYSES OF BILL-AND-KEEP

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November 5,2001

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Introduction

In August 2001, Economics and Technology, Inc. (ETI) issued a report that analyzed the economic and policy foundations of the intercarrier compensation mechanisms applicable to interconnected telecommunications common carriers.[1] That report was submitted in the ongoing Federal Communications Commission (FCC or "Commission") rulemaking proceeding that is considering comprehensive changes to existing intercarrier compensation arrangements, including the possibility of implementing so-called "bill-and-keep" arrangements on a mandatory basis for one or more categories of service.[2] A number of other parties to that proceeding have also submitted economic analyses bearing on these issues. This paper is intended to respond to those alternative perspectives. and thereby to assist the Cornmission in its examination of this uniquely challenging area.

This paper was prepared by ETI at the request of Focal Communications Corp., Pac-West Telecomm, Inc., US LEC Corp., and RCN Telecom Services, Inc. However, the views expressed herein are those of the authors, and do not necessarily reflect the views of its sponsors.

The economic studies offered by other commenting parties confirm the ETI Report's conclusion that bill-and-keep approaches to intercarrier compensation, and specifically the COBAK and BASICS proposals, offer no efficiency advantages or other net benefits over existing arrangements, and should not be adopted on a mandatory basis by the Commission.

Several parties to this proceeding have attached economic studies to their initial comments. These are as follows:

1. Selwyn, Lee L. and Lundquist, Scott C. , "Efficient Intercarrier Compensation Mechanisms for the Emerging Competitive Environment," August 2001 ("ETI Report"), submitted in CC Docket 01-92 as an attachment to the *Comments of Focal Communications Corp.. Pac-West Telecomm, Inc., RCN Telecom Services, Inc. and US LEC Corp.,* filed August 21, 2001 *(Focal et al Comments).*

2. *In the Matter of Developing a Unified Intercarrier Compensation Regime,* CC Docket No. 01-92.

- "Analysis of Central Office Bill and Keep ("COBAK")", Dr. Joseph Farrell and Dr. Benjamin E. Hermalin. August 2001 ("Farrell and Hermalin 2001"), provided as Exhibit I to the Comments of Time Warner Telecom.

- "Network Interconnection with Two-sided User Benefits", Dr. Benjamin E. Hermalin and Dr. Michael L. Katz, July 2001 ("Hermalin and Katz 2001"), provided as Appendix C to Exhibit 1 of the Comments of Time Warner Telecom.

- "Declaration of Janusz A. Ordover and Robert D. Willig on behalf of AT&T Corp.." August 2001 ("Ordover and Willig Declaration"), provided as an attachment to the Comments of AT&T Corp.

- "implementing Bill and Keep Intercarrier Compensation When Incumbent LECs Have Market Power", Patrick DeGraba, August 20, 2001 ("DeGraba Declaration"), provided as an attachment to the WorldCom Comments.

In addition, a number of other parties have supplied economic and policy analyses of the COBAK and BASICS proposals in their comments. The more substantive of these analyses include the following:

- Comments of the National Association of State Utility Consumer Advocates (NASUCA), at Section V ("The Commission's Proposals Violate Economic Efficiency") and Annexes ("Comments on OPP Working Paper **33** by Patrick DeGraba" and "Comments on OPP Working Paper 34 by Jay M. Atkinson and Christopher C. Barnekov").

- Comments of the United States Telecom Association (USTA), at Section IV, Part A ("Some Pros and Cons of Bill and Keep").

- Comments of the Maryland Office of People's Counsel, at Sections 8-11

We have reviewed these analyses, as well as other responses to the Commission's bill-and-keep proposals, and find that they provide further support for our previous conclusions that bill-and-keep does not offer a sound alternative to existing intercarrier compensation mechanisms and should not be adopted by the Commission on a mandatory basis

A. The economic studies confirm that the "equal benefits" and "equal responsibility" assumptions underlying COBAK and BASICS are invalid, and their claimed efficiency benefits are therefore illusory.

As the ETI Report explained (pages 44-45), the COBAK proposal is explicitly premised upon an assumption that the benefits of a telephone call are, on average. shared equally between the caller and the call recipient, and the BASICS proposal rests upon a similar assumption that both parties share equal responsibility for a call. The ETI Report provided several reasons why the assumptions of "equal benefit" and "equal responsibility" are not likely to be valid (pages 46-47). Several of the economic studies filed by other commenters have confirmed this analysis and have expanded on our conclusions.

Ordover and Willig recognize this shortcoming of the COBAK proposal. They find that "there is … little basis in logic or economics for this assumption" (para. 32), and provide further examples that contradict the assumption of equal benefits (para. 33). In addition, they point out that COBAK and other bill-and-keep proposals do not, in fact, follow the principle of equal responsibility, which would imply dividing the total costs for an end-to-end call strictly equally between the two end users involved. Instead, as they conclude, bill-and-keep "requires each party's carrier (and therefore each carrier's end-user) to bear its own costs, and the cost of originating the call may be less than or greater than the cost of terminating the call" (para. 34). The failures of COBAK and BASICS to live up to this principle are particularly noticeable in their varying (and inconsistent) treatments of transport cost, neither of which would result in equal sharing of those costs between the two parties to a call **(see** ETI Report at pages 48-49).

Even if the "equal benefits" assumption happened to be true on average, it clearly does not hold for all particular calls — for example, the random telemarketing call arriving during dinnertime. Ordover and Willig also demonstrate that, relative to traditional Calling Party's Network Pays (CPNP) arrangements, bill-and-keep does a particularly poor job of treating negative externalities, i.e., the costs arising from unwanted calls, including but not limited to telemarketing calls. Because bill-and-keep would shift some of the costs of placing a call onto the call recipient, it would reduce the calling parties' share of the costs of unwanted calls and increase the **supply** of unwanted calls (paras. 36 and footnote 9). Other commenters have also recognized this adverse outcome of bill-and-keep.[3]

3. See. e.g., Maryland OPC Comments at pages 26-28 (bill-and-keep would stimulate inefficient telemarketer calling) and NASUCA Comments at 33 (setting carriers' cost of termination at zero will stimulate demand for telemarketing calls and create a welfare loss).

Ordover and Willig identify another related drawback of bill-and-keep, which is that "B&K actually restricts the ability of consumers to internalize the positive externalities of a call" (para. 35). They explain that CPNP has the flexibility to allow end users to more closely match cost recovery to their respective benefits from calling, so that, for example. businesses that expect to gain disproportionate benefits from customer calls can subscribe to 800-number services and absorb the costs of inward calls (para. 30). In contrast, 800-type services would not be workable under bill-and-keep. because the interexchange carrier would be able to offer called-party-pays pricing on only the interexchange portion of the call (para. 30, footnote 7). The loss of this flexibility means that, all other things being equal. bill-and-keep would be "less likely to produce efficient results" (para. 35).

Even more damaging to the case for bill-and-keep are the two economics papers co-authored by Dr. Hermalin. Taken together, the Farrell and Hermalin analysis. and the companion paper by Hermalin and Katz, provide a convincing demonstration that bill-and-keep, and the COBAK variation in particular, would fail to satisfy the Commission's goal of increasing the efficiency of intercarrier compensation arrangements.

First. Farrell and Hermalin have correctly observed (page 4) that COBAK's assumption that the calling and called parties each derive ***equal*** benefit from telephone calls is a much stronger assumption than merely that both parties benefit, which at least has some intuitive plausibility for most (although certainly not all) calls. As expressed by Farrell and Hermalin (page 4). this is one of the "special, implausible, and crucial assumptions, primarily assumptions of symmetry" that are central to the COBAK framework. The second such assumption made by Dr. DeGraba is that the marginal costs of the interconnecting networks are precisely equal.[4] Farrell and Hermalin demonstrate that this assumption is also "unlikely to bold, because different networks use different technologies and have different blocking probabilities" (page 4).

Second, Hermalin and Katz have provided insights into hill-and-keep's performance when the "equal benefits" and/or "equal marginal costs" conditions are violated. They have developed a series of economic models of two-party communications (including, but not limited to, telephone calls) that analyze the welfare consequences when benefits of the communication may be shared between the two parties. One of those models en-

4. DeGraba, Patrick, ***Bill-and-Keep at the Central Office as the Efficient Interconnection Regime.*** OPP Working Paper No. **33** (December 2000) , at para. 55: see also Hermalin and Katz, at page 26 (Dr. DeGraba analyzed the case of $m_x = m_y$, i.e., equal marginal costs).

compasses the scenario relied upon by Dr. DeGraba in his construction of the COBAK mechanism, as a special case of their more generalized model.[5] The authors demonstrate that. within the limits of this model, Dr. DeGraba's finding that a zero interconnection charge (i.e., bill-and-keep) is an efficient solution holds only for a very narrow range of conditions, outside of which a positive interconnection charge (i.e., an explicit reciprocal compensation scheme) will be the efficient solution *(id.,* at 26). *This finding means that. even in the ideal case (abstracting away ,from all of the daunting implementation problems addressed elsewhere in these reply comments). COBAK, along with other similar forms of bill-and-keep, is unlikely to result in socially optimal, efficient retail prices for telephone service.*[6]

B. The proponents of bill-and-keep have failed to provide any meaningful economic support for establishing a mandatory bill-and-keep regime.

In contrast to these detailed economic analyses, the comments supplied by the proponents of bill-and-keep, including the ILECs and their representatives, fail to provide any meaningful economic support for adopting COBAK, BASICS, or any other bill-and-keep arrangement on a mandatory basis.

USTA makes a sweeping claim that bill-and-keep provides "greater opportunities to achieve economic efficiency" on the grounds that it "reflects principles of cost causation" (USTA Comments at page 21). However, USTA supplies no further analysis of such cost causation or precisely *how* the costs of calls should be split between the caller and the called party, in contrast to the thorough examination of these issues included in the Ordover and Willig Declaration (at paras. 26-37), which reaches precisely the opposite conclusion *(id.* at para 37).

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5. Hermalin and Katz, Section 5 ("Stochastically Dependent Message Values"). In addition to allowing the marginal costs of the two interconnecting networks to vary, their model assumes that the expected values of the communication for each end user are in a linear relationship, which is an extension of Dr. DeGraba's assumption that they are equal. *Id.* at pages 22, 26.

6. Hermalin and Katz also reject Atkinson and Barnekov's assumption that retail prices are independent of the way interconnection is priced. Hermalin and Katz, page 3. This fundamental problem with the Atkinson and Barnekov analysis was also identified in the ETJ Report (pages 39-40).

The initial comments filed by Verizon and SBC do not address the relative efficiency of bill-and-keep and CPNP at all. Qwest contends that bill-and-keep is "at least as efficient" as CPNP in the manner in which it allocates costs between the calling and called parties (page 20). Qwest observes that, after a call has been answered. the called party as well as the calling party could terminate the call at any moment; from this, Qwest concludes that the two parties must be seen as jointly responsible for the costs incurred as the call continues (page 20). However, this reasoning is faulty. because a proper analysis of causation must look to *actions,* not ***potential*** actions. It is insufficient for the purposes of establishing causation relative to a telephone call to say that the called party *could* have hung-up (a potential action), just as it would be inappropriate to conclude that a telephone lineman who was working in the called party's neighborhood caused the call, because he *could* have stopped the call by cutting the line. More to the point. assuming that the inbound call is unwanted, the called party will in any event suffer the inconvenience of having to interrupt whatever he or she is doing to answer the call. make an evaluation of its purpose, and then decide whether to proceed with the call or to bang up. Qwest seems to arrogantly dismiss any "costs" that this unwanted call imposes upon the recipient.

Beyond the causation issue, however, Ordover and Willig have supplied another reason why mandatory bill-and-keep is not likely to be a more efficient solution than CPNP. **As** they have explained (para. 35), mandatory bill-and-keep would fail to afford the two parties any flexibility to negotiate an allocation of those costs that would match the benefits they receive from the call, and therefore is less likely to result in efficient outcomes than CPNP, where such negotiation is possible.

BellSouth also appears to assume that bill-and-keep will increase the efficiency of intercarrier compensation (page 16), hut narrowly focuses only upon the potential efficiency gains that might result from eliminating the "regulatory gaming" it contends has been occurring under existing reciprocal compensation arrangements (pages **2-3).** BellSouth provides no specific evidence concerning the magnitude of those alleged efficiency gains, but even if it had, the Commission would have to consider them in the context of the overall efficiency impacts of a change in the interconnection regime. Moreover, this pejorative attribution of the existing market outcome as "regulatory gaming" ignores the fact, as we addressed in the initial ETI Report, that the prevailing reciprocal compensation rates to which CLECs have been induced to respond were for the most part dictated by the ILECs based upon their flawed assessments of the ability of CLECs to seek out customers with disproportionate inward calling requirements. The only "regulatory gaming" that is occurring here is the effort by some ILEC parties to invoke regulatory intervention, rather than a legitimate market response, to insulate them from competitive losses with respect to the delivery and termination of inbound calls.

Of course. there are also several important objectives beyond optimizing efficiency that the Commission must balance when considering changes to existing intercarrier compensation mechanisms. We have previously identified the objective of promoting *regulatory certainty* in this area as crucial to the financial viability of CLECs *(Focal **et** al Comments.* at pages 1-4). NRTA and OPASTCO (page 13) also advise the Commission against rushing into a bill-and-keep regime based upon speculative efficiency gains, finding that "an intercarrier compensation regime in which market efficiency and facilitating competition were the only goals would be disastrous in rural areas where there is hardly a market. unless there were specific, effective mechanisms implemented concurrently to deal with the universal service impacts." The universal service implications of bill-and-keep are taken up later in these comments.

The Initial Comments filed by other parties confirm our view that mandatory bill-and-keep would offer little or no incremental efficiency benefit unless it was applied to all forms of telecommunications traffic, which itself presents daunting challenges.

The ETI Report notes that the FCC economists who developed the two economic variations of bill-and-keep explicitly considered in the NPRM, the "COBAK' and "BASICS" proposals, assert that these devices would have to be applied to the widest possible range of telecommunications traffic in order to be effective. (ETI Report, at page 43) Dr. DeGraba's Declaration, attached to the initial comments of WorldCom, reiterates that point. As he states:

> Finally, COBAK is meant to be a unified approach to interconnection, meant to apply to all forms of traffic that use the public switched network. Implementing COBAK on a piecemeal basis could actually increase in some instances the incentives for service providers to engage in regulatory arbitrage. A piecemeal implementation would also prevent the markets from realizing all of the efficiencies that could be obtained if all facilities were provisioned under a single set of rules.[7]

A number of other commenters, including ILECs. also recognize that bill-and-keep is unlikely to afford significant benefits from the status quo unless it is adopted for a wide range of traffic types. USTA concludes (page 26) that two of the conditions that "must be present to adopt bill and keep" is "application to all carriers, networks, and tech-

7 DeGraba Declaration, at 32

nologics" and "application to both the intrastate and the interstate jurisdiction." SBC similarly supports application of bill-and-keep on a wide basis, including all Internet traffic. local calling, and wireless traffic (pages I and 24). SBC also supports extension of bill-and-keep to both intrastate and interstate access, provided that alternative end user recovery mechanisms are established beforehand (pages 1 and **24-25).** According to SBC. if the Commission adopts bill-and-keep for only a limited subset of services. e.g., for interstate services but not for intrastate service, that bifurcation will create the conditions for arbitrage (page *25)*. BellSouth makes the same point, and concludes that "in order for bill-and-keep to operate as intended, it must be implemented uniformly across state and interstate jurisdictions" (page 4).

The catch is that any attempt to implement mandatory bill-and-keep on a wide scale basis will create enormous transitional problems. Some of these have been identified and explained in the ETI Report (see pages 39-43). However, other commenters, including proponents of mandatoxy bill-and-keep, have raised other issues that create daunting challenges to a successful implementation of a unified bill-and-keep regime.

For example, SBC urges the Commission to adopt a modified version of COBAK (page 25), but finds that "before the Commission can implement a uniform bill and keep regime. it finally must tackle the difficult issues of implicit subsidies and universal service reform" (page **2).** SBC claims (page **22)** that "many states, either through state statute or regulation, have capped local service prices. These price restrictions are plainly incompatible with a shift from implicit subsidies to explicit recovery, and from intercarrier compensation to bill and keep." Of course, SBC neglects to point out that most of the ILEC price cap plans that are in place were initiated by the ILECs themselves, and in many instances granted ILECs pricing freedom for non-basic services in return for the protection of basic services customers from price increases. In any event, SBC is contending that the Commission and state regulators will have to undertake the following fundamental changes to the telecommunications regulatory regime before adopting mandatory bill-and-keep:

- Allow increases in ILECs' residential local service rates, ostensibly to replace the loss of implicit subsidies from access charges and other services (page 21);

- Allow geographic deaveraging of ILECs' residential local rates, which SBC claims amounts to another form of implicit subsidies (page **21);**

- Perform a "fundamental reexamination" of universal service funding (USF) mechanisms (page **22)** and establish an affordability threshold, defined as a percentage of median household income, for end users to quality for USF assistance (page **23):**

- Allow ILECs to establish new end user charges to recover the costs of originating and terminating switched access, as well as network-to-network transport costs, and furthermore. grant them pricing flexibility as to the level and type of charges they will impose (pages 31-32).

Even if all of these revisions were necessary (and we do not believe that they are), they clearly represent extremely far-reaching and controversial changes. A thorough examination of the underlying issues would require an unprecedented effort by the Commission and state regulators, and intervention by the full range of telecommunications industry stakeholders. While SBC believes that immediate action by the Commission could allow bill and keep to be implemented by July 2005 – i.e., a minimum delay of four years – that schedule appears to be far too optimistic, given that the Commission already has been engaged in universal service reform for five years and has not yet resolved many outstanding issues.[8]

Data supplied by USTA indicates that full implementation of bill-and-keep would expose end users served by larger ILECs to rate increases in the range of $7.82 per line per month, with the prospect of much higher rate impacts in certain situations,

The USTA takes a cautious approach to the Commission's bill-and-keep proposals. While USTA ultimately supports the concept of bill-and-keep, it also expresses a number of serious reservations. First, it finds fault with the proposed COBAK and BASICS plans, concluding that "the BASICS bill and keep proposal would be difficult to implement and administer and would require regulatory intervention" (page iii), and that "using the central office as the POI as proposed in COBAK raises many concerns since carriers may locate their switches great distances from where the call actually terminates" (page iii). More generally, USTA concludes (page ii) that "there also may be harms associated with bill and keep, particularly if current access revenue streams are displaced and end user recovery is required, regarding the affordability of rates, the ability to

8. For example, the Commission decided in May 1997 that ILECs' universal service funding requirements should be evaluated using a forward-looking cost model, but four years later, it has had to adopt an embedded cost mechanism for rural carriers because of the difficulty in determining appropriate cost inputs for a forward-looking model. See *Fourteen Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket No. 96-45, and Report and Order in CC Docket No. 00-256, FCC 01-157*, released May 23,2001, at para. 174.

maintain end user rates that are reasonably comparable between urban and rural areas and the incentives to invest in the infrastructures."

USTA's concerns regarding the affordahility of rates, and maintenance of reasonably comparable urban vs. rural rates, are premised upon the notion that, whatever the Commission decides to do. ILECs will in any event he made whole with respect to aggregate revenues. We do not view this as a foregone conclusion, since at least some of the impact upon ILEC revenues would he the result of competitive losses rather than of any modification in the formal compensation mechanism. Nevertheless, USTA presents data on the potential end user impacts that would follow from shifting the recovery of switched access costs to end users, under a COBAK scenario. USTA claims that the monthly per line impacts would be at least $7.82 per line for those users served by the larger carriers (page 23).[9] The end users served by smaller carriers would face much higher monthly charges, in the range of $134.15 per line." USTA has not supplied any workpapers that explain how those figures were calculated or that demonstrates their linkage with COBAK in particular, so we are not able to verify their accuracy. Moreover, USTA appears to take the position that ILECs must be made whole for any potential revenue losses that might result from a transition to mandatory hill-and-keep, even though at least some, and perhaps a substantial share, of those "losses" would be the result of competition and not of revisions to the intercarrier compensation regime. Moreover. ILECs' switched access rates are generally priced well in excess of economic cost and their current interstate earnings are well in excess of the 11.25% "authorized level." Nevertheless, it is fair to conclude from USTA's figures that the ILECs can he expected to petition state PUCs for substantial increases to their retail rates in the event that bill-and-keep was adopted as a substitute for access charges, and that end users would be at risk for absorbing those rate increases.

The Regulatory Commission of Alaska (RCA) has supplied further data that demonstrates that a movement to hill-and-keep would have even more severe impacts on Alaska's end users. The RCA estimates that if hill-and-keep were applied to interstate switched access only, about one-third of Alaska's ILECs would need to charge end users

9. USTA reports that. for carriers with over 50,000 lines, the intrastate impact would be a minimum of $0.12 per line for certain carriers, whereas the interstate impact would be no less than $7.70 per line (page 23).

10. This value reflects USTA's estimates of maximum monthly impacts for intrastate access of $88.05 per line, and $46.10 for interstate access (page 23), assuming that the current Subscriber Line Charge (SCL) caps remain in place. These figures are for carriers within specific size categories, and USTA notes that some individual carriers would have rates much higher than those averaged values (page 24, footnote **37).**

about $20 per month more than their current local exchange rates. and some users would face monthly per-line charges of $35 to $60 (page 2). Recovering intrastate access costs via bill-and-keep would add another $35 to $100 to the bills faced by end users served by a third of Alaska's ILECs (page 2). As the RCA points out (page 3). bill-and-keep appears to be incompatible with the existing NECA access pooling mechanism, which today limits the end user impacts arising from high costs of service in rural areas. If the NECA pool is dismantled and end users are charged directly by ILECs for the costs of access services in their areas, then it is certain that some users will face extremely high. and likely unaffordable. fees for access. Without the rate averaging created by the NECA pool. end users in rural areas such as Alaska would pay much more for access than would end users in more densely populated, non-rural areas, which directly contradicts the Act's requirement that rural and non-rural telephone rates should be "comparable" (page 3).

The threat that such potential end user charges would pose to universal service can hardly be ignored. Carrier representatives have also recognized this fundamental hurdle to bill-and-keep. NRTA and OPASTCO have concluded (page v) that "a bill-and-keep regime would certainly make it more difficult for the Commission to preserve and advance universal service – and impossible if the USF remains capped." While the NPRM places a great deal of emphasis on the objective of increasing the efficiency of intercarrier compensation mechanisms and pricing, the Commission must ensure that a single-minded pursuit of great efficiency does not disrupt the progress toward other important industry goals, such as fostering universal service.

Conclusion

The authors have reviewed the other economic studies filed in the initial round of comments in CC Docket No. 01-92, and find that they generally confirm the conclusions presented in the original ETI Report. In particular, we find that the economic evidence in the record leads to the conclusion that mandatory bill-and-keep would be unlikely to improve the economic efficiency of intercarrier compensation arrangements, especially if it was introduced selectively for certain service categories only (such as ISP-bound, locally-rated traffic). Moreover, we also find that almost no parties — not even the ILECs — profess unqualified support for a mandatory, uniform regime of bill-and-keep. Instead. a wide range of commenters have identified numerous drawbacks to the proposals advanced in the NPRM, and have raised a cloud of difficult issues and uncertainties that would have to be addressed before the Commission could adopt any bill-and-keep scheme. When these problems are considered together with the slim prospects for achieving any net economic benefits from the radical restructuring of intercarrier compensation to a bill-and-keep regime, the only reasonable conclusion is that the Commission's proposals to establish mandatory bill-and-keep should be abandoned.

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